No. 7961

In the United States Circuit Court of Appeals

For the Ninth Circuit.

Francisco Building Corp. Ltd., a corporation,

Appellant,

vs.

Leigh M. Battson, as trustee, and H. H. Cotton, Charles C. Irwin, John Treanor and J. B. Van Nuys, as the Medical Center Building First Mortgage Bondholders' Protective Committee,

Appellees.

APPELLANT'S OPENING BRIEF.

ELBERT E. HENSLEY,
JOHN H. KLENKE,
Insurance Exchange Bldg., 318 W. 9th, L. A.,
Attorneys and Solicitors for Appellant.

Parker, Stone & Baird Co., Law Printers, Los Angeles.

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

STATUTES.

No. 7961

In the United States Circuit Court of Appeals

For the Ninth Circuit.

Francisco Building Corp. Ltd., a corporation,

Appellant,

vs.

Leigh M. Battson, as trustee, and H. H. Cotton, Charles C. Irwin, John Treanor and J. B. Van Nuys, as the Medical Center Building First Mortgage Bondholders' Protective Committee,

Appellees.

APPELLANT'S OPENING BRIEF.

To the Honorable the Judges of the United States Circuit Court of Appeals, for the Ninth Circuit:

Prefatory Statement.

This appeal by the Francisco Building Corp. Ltd. above named, debtor appellant, is from an order made by the Honorable William P. James, Judge of the United States District Court, Southern District of California, Central Division, sustaining certain objections and exceptions made by appellees, to a proposed plan of reorganization presented by appellant in the trial court, disapproving

and rejecting such plan, and vacating and setting aside a restraining order previously made. Due exception was taken to said order and the same will be found at page 94 of the transcript duly filed herein. Thereafter and within the time required by law, appellant duly presented petitions for leave to appeal, said petitions being presented to this Honorable Court as well as to the trial court. The appeal was allowed by both courts as provided in the Bankruptcy Acts and duly perfected.

Statement of the Case.

From the allegations and matters set forth in appellant's petition for reorganization and amendment to petition for reorganization duly filed herein and which allegations have not been controverted or denied by the appellees, the following facts are ascertained: Appellant is engaged in the business of owning and operating a thirteen story re-enforced concrete fireproof office and store building, located at the northeast corner of Eighth and Francisco streets, Los Angeles, California; its assets consist of the land upon which said building is located, the said building, equipment, fittings and fixtures therein, rents, issues, income and profit therefrom and appurtenances thereto, personal property situated therein for the use or occupation of the building generally, accrued rents, accounts receivable and moneys held by the trustee in a segregated special owners account. Appellant owns and holds said building subject to a certain trust deed and chattel mortgage made and executed on or about December 1, 1924, in the principal sum of $615,000.00, which trust deed and chattel mortgage secured a like amount of 6% first mortgage gold bonds; that there are outstanding unpaid bonds in the aggregate principal amount of $524,500.00.

In view of appellees' objection and exception No. V; [Tr. p. 48] it becomes material and relevant to ascertain the exact status and relationship of debtor and appellant to appellees and the manner and means whereby its assets were acquired. This has been specifically set forth in an amendment to the petition for reorganization allowed by permission of the trial court on July 1st, 1935, sets forth the following uncontroverted facts:

In and prior to 1924 the land upon which the said building was to be constructed was owned by Bernice M. Crail and Joe Crail. During the said year the Morgan Building Corporation entered into negotiations to purchase the same for the purpose of erecting a thirteen story building thereon. To finance the erection of the said building Morgan Building Corporation, after receiving the deed to the said land from the Crails, made and executed a promissory note, dated December 1, 1924, to William K. Bows as trustee, in the principal sum of $615,000, which said note was secured by a trust deed of the same date on the said land and premises and building to be erected thereon. Thereafter, and on December 10, 1924, the said Morgan Building Corporation made and executed a second trust deed to Charles S. Crail as trustee, to secure the payment of two promissory notes in the total sum of $80,000, being the balance of the purchase price of the land on which said building was to be erected.

The William Simpson Construction Co. obtained a contract and became the general contractors to construct said building. Among the architects, engineers, material

men, artisans, mechanics, contractors and sub-contractors constructing said building, supplying the materials therefor and labor thereon, were:

T. V. Allen;
Arenz-Warren Company;
A. J. Bayer;
Montgomery Bennett;
California Glass Company;
Thomas Haverty;
John Milner;
Newberry Electric Corporation;
Walker & Eisen;
Harry W. Watson.

During the course of construction and before the building was completed, it was ascertained that the money realized by the Morgan Building Company from the bond issue would be inadequate and insufficient to complete the construction thereof. In order to complete the construction of the said building, and thereby protect, preserve and complete the security of the owners and holders of Medical Center bonds and the underwriters thereof, who were S. W. Straus & Co., it was necessary for the aforesaid architects, engineers, material men, artisans, mechanics, contractors and sub-contractors to do further work, furnish further materials, perform further services in the aggregate cost thereof to them of approximately $130,000 in excess of the amount for which they had or would receive compensation and payment in cash.

If these architects, engineers, material men, artisans, mechanics, contractors and sub-contractors furnished the

said materials and performed further services and completed the building they might, under the laws of the state of California, have a prior lien upon the land and premises for the unpaid amount of their charges, to-wit, the approximate sum of $130,000, which lien would have been a preferred and prior mechanic's lien. However, in order to further protect and preserve the security of the bondholders and complete the building, the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors agreed to waive their prior preferred mechanics' liens and in lieu thereof, accept two promissory notes of the Morgan Building Corporation, dated January 20, 1925, in the aggregate sum of $130,000, payable to the Title Guarantee & Trust Company as trustee, which said notes represented and were the unpaid balance due for the construction of the said building and for which preferred prior mechanics' liens could have been filed pursuant to law. These notes were secured by a deed of trust to the Title Guarantee & Trust Company as trustee, for the benefit of the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors, which trust deed was subject to the first trust deed securing the bond issue and the second trust deed for the balance of the purchase price.

After the completion of the building the occupancy thereof had been very good, the gross annual income therefrom for a long time exceeding $100,000 a year. In 1928 the Morgan Building Corporation, who had been operating the building, were in default in the payment of principal and interest on the two notes totaling $80,000, representing the balance of the purchase price and the trustee, Charles S. Crail, threatened to foreclose the same, thereby depriving the aforesaid architects, engineers,

material men, artisans, mechanics, contractors and sub-contractors of the balance due them for the work performed and materials furnished by them and each of them in the completion of the said building and in preserving, protecting and enhancing the security of the bondholders. To protect their claim it was necessary to buy the two notes and trust deeds from Bernice M. Crail, Charles S. Crail and Joe Crail and the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors did pay the sum of $91,541.40 in cash therefor. In addition to the aforesaid expenditures, certain of the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors had fourth liens on the Medical Center Building for and on account of work, labor and services, material furnished and performed by them on said building, in the total sum of $38,338.35. Also, they had accounts receivable against the said building in the further sum of $6,364.35.

By reason of the foregoing, said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors had paid out and expended in cash in the said building, the total sum of $168,338.35, in completing the construction of the said building, and the further sum of $91,541.40 in paying off the balance of the purchase price of the land upon which said building was situated.

During 1929 it was decided that the Morgan Building Corporation would withdraw from the ownership and management of the building, conveying the same to the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors or someone they would designate as their agent or representative, subject to the first trust deed. Thereupon, the said architects, engineers, material men, artisans, mechanics,

contractors and sub-contractors determined to unite all of the several proportionate shares of their interests into one central body, such as a corporation, to establish unity of purpose, and control, and did organize under the laws of the state of California, the Francisco Building Corporation, Ltd.; that the said corporation is, in truth and in fact, the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors who, by corporate means combined their respective interests into one body for unity of purpose and control. By mesne conveyances and certain foreclosures of trust deeds and on or about February 5, 1930, the Francisco Building Corporation Ltd. became the owner and holder of the legal title to the land, building and premises formerly known as the Medical Center Building and which was then known as the Medico Dental Building; subject to the first trust deed. Stock of the said corporation was issued to the said architects, engineers, material men, artisans, mechanics, contractors and sub-contractors in proportion to the amount or amounts severally advanced by them in constructing and completing the said building in the purchase of the second trust deed and the cancellation of liens or open accounts.

When the architects, engineers, material men, artisans, mechanics, contractors and sub-contractors took over the management, operation and control of the building they further placed in a bank account and as operating capital, the sum of $3,968.60 in cash.

The total amount laid out, invested, expended or canceled by the architects, engineers, material men, artisans, mechanics, contractors and sub-contractors in the construction of said building and for the benefit of the bondholders of Medical Center bonds, and to protect, preserve,

enhance and complete the security of the said bonds, was and has been the sum of $270,202.70.

The property and principal assets of the Francisco Building Corporation Ltd. are subject to the claim or lien of the owners and holders of the aforesaid Medical Center six percent first mortgage gold bonds and such owners and holders of the said bonds have a claim or claims against the appellant and its property. Appellant took over the ownership and operation of the building and in June of 1932, defaulted in the interest payment then due. Thereupon the substituted trustee under the trust deed, to-wit, Leigh M. Battson, served notice of acceleration upon debtor, declaring the entire unpaid principal of all of the outstanding unpaid bonds to be due and payable. Because of this default, the said trustee did, on September 26, 1933, enter upon and take possession of the said building together with all of its equipment, fittings and fixtures and has been, since then, operating the same, collecting all the rents, issues and proceeds therefrom.

Between September 26, 1933 and the date of the filing of the petition for reorganization, to-wit, April 19th, 1935, said trustee has, on numerous occasions, threatened to sell said property under the terms of the trust deed, which sale was finally restrained by order of court issued April 20th, 1935.

By a deposit agreement dated May 18th, 1935, Messrs. H. H. Cotton, Chas. C. Irwin and John Treanor were constituted a Medical Center Building first mortgage bondholders protective committee and thereafter proceeded to function as such under the terms of their agreement. Thereafter, in conjunction with, and through the cooperation of S. W. Straus & Company, the underwriters of the

said bonds, they actively solicited the deposit with them of the outstanding defaulted bonds. The protective committee, appellees herein, who were the objectors in the lower court, are a self-constituted body, undoubtedly under the domination and control of S. W. Straus & Company, the underwriters, and formed for their own as well as the Straus Company's pecuniary gain and advantage and are not representative of the true interests of the actual bondholders. This is readily apparent when it is ascertained that the trustee, Leigh M. Battson, was actively interested in S. W. Straus & Company and in their successors. The self aggrandisement, enrichment and spoliation of such so-called "Protective Committees" has been a matter of national scandal. In fact, the repute of the Straus committees has been of such a nature as to result in congressional investigation.

Under date of June 26, 1934, the bondholders' committee proposed a plan of reorganization for the Medical Center Building, which plan is incorporated in the transcript at pages 67 *et seq.* It will be observed that under the terms of said plan, a provision is made wherein and whereby the control of the said building is, and may be still retained in the parties who are now controlling the deposited bonds. The pecuniary advantage and gain of such a provision is self-apparent.

Thereafter, appellant, on April 19, 1935, filed a petition for reorganization under the provisions of section 77B. On April 20th, 1935, the trial court made its order finding (1) that the petition of appellant was properly filed; (2) that reorganization was necessary and proper in order to propose and effect a plan of reorganization of appellant's fixed charges and obligations and of its assets; (3) that the petition was filed in good faith and (4)

restraining any sales of its property. [Tr. p. 17 *et seq.*] In said order it was further provided that within thirty days from the date thereof a plan of reorganization should be filed. Thereafter and pursuant to said order and on May 20th, 1935, appellant filed its proposed plan of reorganization. [Tr. p. 20 *et seq.*] At that time the court made its order setting July 1st, 1935 as the hearing date thereon and in said order, provided for notice and service of the plan. [Tr. p. 36.] Pursuant to the order, notice of the hearing was published in the newspaper therein designated for the required time, and a copy of the plan and order were personally served upon appellees, who thereafter appeared and filed their objections and exceptions [Tr. p. 40] together with their petition for an order rejecting the plan and vacating and setting aside the restraining order. [Tr. p. 51.] A hearing on the proposed plan was had on July 1st, 1935. During the hearing, the attorneys for appellant stated in open court and here again state to this Honorable Court that appellant was willing to, and would make any reasonable concession or amendment to a proposed plan of reorganization that might or would be required in order that the same be fair, equitable and adequately protect and provide for the rights of all of the interested parties and which would consider and preserve the equities and rights of appellant in and to said property.

On July 29th, 1935, an order was made sustaining the aforesaid objections and exceptions, rejecting and disapproving the plan, and setting aside the restraining order, to which order appellant then and there duly and regularly excepted and still excepts thereto. Thereafter, and within the time required by law this appeal was prosecuted and duly perfected under both of the alternative provisions as provided for in the Acts of Bankruptcy.

Specification of Errors Relied Upon.

Appellant respectfully submits, for consideration by this Honorable Court, the following specifications of error which are relied upon on this appeal, asserting that the trial court erred as follows:

1. That the said order rejecting debtor's proposed plan of reorganization and vacating and setting aside restraining order, and dismissing these proceedings, was not in accordance with the law. [Tr. p. 98.]

2. That the Court, in making said order, in effect held that section 77B of the Acts of Bankruptcy as amended is invalid and unconstitutional. [Tr. p. 109.]

3. That the Trial Court, in making said order, in effect held that Section 77B of the Acts of Bankruptcy as amended, was invalid and unconstitutional in that the same was not a law on the subject of bankruptcy and did not deal with any subject over which power is delegated to Congress and is therefore in contravention of the Constitution of the United States, and particularly the 10th Amendment thereof. [Tr. p. 112.]

4. That the Court, in making said order, in effect held that section 77 B of the Bankruptcy Act, and particularly subdivision (b) thereof was invalid and unconstitutional and that it deprived bond holders and/or creditors of substantive rights and would constitute the taking of property without due process of law in violation of the United States Constitution. [Tr. p. 98.]

5. That the Court, in making said order, in effect held that under the provisions of section 77 B of the Bankruptcy Act any plan of reorganization proposed thereunder could only become effective upon its acceptance in writing by at least two-thirds (⅔) in amount of the creditors of such petitioning debtor. [Tr. p. 98.]

6. That the Court, in making said order, in effect held that if section 77B of the Acts of Bankruptcy as amended allowed, permitted or authorized the Court to in any wise or at all scale down the indebtedness of the bond holders, it was invalid and unconstitutional. [Tr. p. 109.]

7. That the Court, in making said Order, in effect held that the proposed plan of reorganization had not been accepted as required by the provisions of subdivision E, clause 1 of section 77B of the Acts of Bankruptcy as amended. [Tr. p. 110.]

8. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein, whereby the bond holders were deprived of interest on the bonds accruing and unpaid as of July 1, 1935, was invalid and unconstitutional and would constitute the taking of property without due process of law, in violation of the United States Constitution; and that any provision or provisions of the Acts of Bankruptcy which allowed or permitted the deprivation of accrued interest unpaid would be invalid and unconstitutional and would constitute the taking of property without due process of law in violation of the United States Constitution, and that a Court of Equity or of Bankruptcy had no power, right or authority to deprive creditors or lien holders of accrued interest on their claims under any plan of reorganization. [Tr. p. 99.]

9. That the Court, in making said order, in effect held that the proposed plan deprived the bond holders of their right to retain the lien until the indebtedness secured thereby was paid and thereby in effect held that the provisions of the Acts of Bankruptcy, and particularly section 77B thereof, allowing and permitting such deprivation and depriving creditors of their right to retain the lien until the indebtedness thereby secured is paid, is invalid and unconstitutional and that it would result in the

deprivation to creditors of substantive rights and would constitute the taking of property without due process of law in violation of the United States Constitution. [Tr. p. 100.]

10. That the Court, in making said order, in effect held that the proposed plan of the debtor proposes to deprive bond holders of the right to realize upon the security by a sale conducted by the trustee appointed in the trust indenture or by a judicial public sale, and thereby in effect held that the provisions of the Acts of Bankruptcy, and particularly of section 77B thereof, which authorize such procedure and such deprivation, are invalid and unconstitutional and would result in the deprivation to creditors of substantive rights and would constitute the taking of property without due process of law in violation of the United States Constitution. [Tr. p. 101.]

11. The Court in making such order in effect held that the proposed plan of the debtor proposes to deprive the bond holders of the right to determine when a sale of the security, conducted by the trustee appointed in the trust indenture, or by a judicial public sale of the security, should be held, subject only to the discretion of a Court of Equity, and in effect held that a Court of Equity has no such right or discretion, and further thereby in effect held that the provision of the Acts of Bankruptcy, and particularly section 77B thereof which would authorize such procedure and such deprivation are invalid and unconstitutional and would result in the deprivation to creditors of substantive rights and would constitute the taking of property without due process of law in violation of the United States Constitution. [Tr. p. 101.]

12. That the Court, in making said order, in effect held that the proposed plan proposes to deprive the bond holders of the right to protect their interests in the prop-

erty by bidding at such sale, whenever held, and thus to insure having the mortgaged property devoted primarily to the satisfaction of the debt whether through the receipt of the proceeds of such sale or by the taking of the property itself, and thereby in effect held that the provisions of the Acts of Bankruptcy, and particularly of section 77B thereof, which authorizes such procedure and such deprivation, are invalid and unconstitutional and would result in the deprivation of creditors or bond holders of substantive rights and would constitute the taking of property without due process of law, in violation of the United States Constitution. [Tr. p. 102.]

13. The Court, in making said order, in effect held that the proposed plan proposes to deprive the bond holders of the right to have Leigh M. Battson, as trustee, or the trustee named in the trust deed and chattel mortgage, control the mortgaged property during the period of default and to have the rents and proceeds collected by said trustee sequestered for the benefit of the bond holders, and thereby in effect held that the provisions of the Acts of Bankruptcy, and particularly section 77B thereof, which authorizes such procedure and such deprivation, are invalid and unconstitutional and would result in the deprivation of creditors or bond holders of substantive rights and would constitute the taking of property without due process of law, in violation of the United States Constitution. [Tr. p. 102.]

14. That the Court, in making said order, in effect held that the petitioning debtor herein was not a debtor within the meaning of the provisions of section 77B of the Bankruptcy Act and could not, by reason thereof, avail itself of said provisions, and furthermore, that the bond holders were not its creditors since the bonds were not issued or assumed by the debtor. [Tr. p. 108.]

15. That the Court, in making said Order, in effect held that it was not satisfied that the proposed plan of reorganization was fair and equitable and did not discriminate unfairly in favor of any class of creditors or stockholders, and was feasible. [Tr. p. 110.]

16. The Court, in making said order, in effect held that the debtor's proposed plan of reorganization did not adequately protect the bond holders for the realization by them of their interests; that such holding is against the evidence in that the said proposed plan is equitable and proposes that the bond holders, who were the only creditors of the petitioning debtor, should retain all of the equities or lien rights which they previously had on the debtor's property as an adequate protection for the realization by them of their interests, there being no change in the security of their bonds or of the relative position of the bond holders. [Tr. p. 103.]

17. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein did not adequately protect or provide for the interests of the bond holders because under the provisions of the said plan when the earnings of the property were low, the bond holders would receive only a minimum interest of 2%, and in periods when earnings were high, all earnings in excess of 8% per annum of the principal amount of the outstanding proposed new issue of bonds (5% of which, if earned, being required to be paid as interest, and 3% of which, if earned, to be required to be paid on the principal) would go to the stockholders of the petitioning debtor; that such holding is against the evidence and the terms and provisions of the said plan as amended, for all funds received over and above the immediate operating expenses and preferred expenditures, as set forth in the proposed plan (Art. III, sections 4 and 6 thereof) would

go to and be used for the payment of interest and retirement of the principal on the proposed new issue of bonds; no part of such funds to be returned to the debtor corporation for corporate purposes. [Tr. p. 103.]

18. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein did not adequately protect or provide for the interests of the bond holders, and that under the provisions of the said proposed plan the maximum amount of the principal sum of the new issue of bonds which is required to be retired out of the income is 3% per year, or approximately 45% over the entire fifteen (15) year term of the proposed new bonds, thereby resulting in 55% of the principal amount of the proposed new issue of bonds being unretired at the maturity date thereof; the proposed plan requiring that 2% earned be applied to the interest, the succeeding 6% to be divided equally, 3% to interest and 3% to principal retirement, and if the succeeding 6% should not be earned, whatever, if anything, is earned on account of it, to be divided equally between payment of principal and interest; the extra 3% interest payments being noncumulative; and that if, during the said years, the earnings would be insufficient to pay anything on account of retirement of principal, and if, during other years, the earnings would be more than adequate for such purpose, then during such other years the debtor would be allowed or permitted to have an interest in the excess, irrespective of the earnings; and that the proposed plan did not require the retirement of more than 45% of the bonds prior to maturity; that such holding is against the evidence and the terms and provisions of the said plan as amended, for all of the income received from the operation and management of the building over and above the immediate operating expenses and preferred expenditures, as set forth in the proposed plan (Art. III, sections 4 and 6 thereof) would go to the payment of interest on the proposed new issue of bonds and retirement

of the principal thereof, no part of said sum to be turned over to the debtor corporation for corporate use, including dividends. [Tr. p. 104.]

19. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein did not adequately protect or provide for the interests of the bond holders in that the proposed plan permitted the debtor to pay dividends out of the earnings of the said property even though it may not have paid any interest or principal payments in previous years; that such holding is against the evidence and the terms and provisions of the said plan as amended, for the attorneys for all income from the operation and management of the said building over and above operating expenses and preferred expenditures as set forth in said proposed plan (Art. III, Par. 4 and 6 thereof) would go to the payment of interest on the proposed new bond issue and the retirement of the principal thereof. No part of such funds to be turned over to the petitioning debtor to be used for corporate use including payment of dividends. [Tr. p. 106.]

20. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein, did not adequately protect or provide for the interests of the bond holders and that the proposed plan required that net income, if any, equal to only 8% per annum of the principal amount of the outstanding bonds, should be devoted to the payment of principal and interest, the balance of net income to be distributed to the stockholders of the debtor corporation, even though the bond holders may not have received payments of principal or interest during previous years; that such holding is against the evidence and the terms and provisions of the said plan as amended, for all income from the operation and management of the building over and above operating expenses and preferred expenses as set forth in said proposed plan (Art. III, sections 4 and 6 thereof) would

go to the payment of interest on the new bond issue and the retirement of the principal thereof; no part thereof to be turned over to the debtor corporation for corporate use including payment of dividends; further, that the proposed plan provided that a minimum interest rate of 2% per annum must be paid, otherwise default would be declared. [Tr. p. 107.]

21. That the Court, in making said order, in effect held that the proposed plan of reorganization of the debtor herein proposed to scale down the principal amount of the outstanding bonds from $524,000.00 to $340,900.00; that such holding is against the evidence and the terms and provisions of the said plan as amended, there would be no scaling down of the principal amount of outstanding bonds, the old and outstanding issue of bonds being substituted for the new issue of bonds dollar for dollar. [Tr. p. 99.]

22. That the Court, in making said order, in effect held that the petitioning debtor could not carry out the proposed plan because a permit of the California Corporation Commissioner would be required and that under the rules and regulations of the said Commission effective as of June 7, 1935, a permit could not be obtained to issue the new bonds. That such holding is against the evidence for, at the hearing thereon, the attorneys for the petitioning debtor stated they were willing to and would amend the proposed plan in all respects to comply with the rules and regulations of the California Corporation Commissioner. [Tr. p. 108.]

Specifications 1 to 13 inclusive are generally considered under Appellant's first point of the argument; specification 14 deals with the subject matter discussed in appellant's second point; and specifications 15 to 22 are generally considered and discussed in Appellant's third point.

Statement of Questions Involved.

The order of court to which exception has been and is taken and from which this appeal is prosecuted, would seem to sustain each and all of the objections and exceptions interposed by appellees to the plan of reorganization as amended. By reason of the seemingly broad terms of the said order it was deemed advisable and necessary to assign numerous specifications of error covering each and all of the objections and exceptions set forth by appellees. However, irrespective of the fact that the order is seemingly broad and general in its nature, and of the numerous assignments of error herein made, appellant respectfully asserts that the primary questions presented for consideration and determination upon this appeal by appellees objections and exceptions, by the order of the trial court to which exception has been taken and allowed and by the assignments of error made herein may, without limiting the scope of appellants argument, be generally stated to be:

1. Is section 77B of the Acts of Bankruptcy constitutional? And if it is, what are the powers of a court thereunder?

2. Is appellant, Francisco Building Corp. Ltd., a debtor within the meaning, provisions and definitions of section 77B?

3. Is the plan of reorganization proposed by the debtor-appellant, as amended, made in compliance with section 77B? And is it fair, equitable and feasible?

Argument.

At the hearing on appellants proposed plan appellant offered to make any reasonable amendment or concession that the trial court might suggest or require in order that it be fair, equitable and feasible and adequately consider and provide for the rights, interest and equities of all of the parties. In answer to this offer, appellees challenged the very power and jurisdiction of the court to approve any plan in this case which they did not approve, they contending that section 77B was unconstitutional because:

1st. It is not a law upon the subject or bankruptcies and the powers therein contained and set forth far exceeded the authority delegated to Congress under Article I, section 8, clause 4 of the Constitution; and

2nd. That if it was a proper law on the subject of bankruptcies it could not authorize, empower or confer jurisdiction on a court to approve any plan of reorganization which had not been approved by at least two thirds in amount of creditors, particularly where it was contended that such a plan and the approval thereof would deprive non-assenting creditors of certain alleged substantive property rights without due process of law in contravention of the fifth amendment of the Constitution.

Approval of any plan of reorganization by appellees was, of course, out of the question and appellant's counsel so advised the court, for appellees have long and consistently failed and refused to consider appellants position and rights in the property.

Therefore the first and one of the fundamental questions presented for consideration and determination on this appeal is that of the validity and constitutionality of section 77B, and the power of the court thereunder.

I.

Section 77B of the Acts of Bankruptcy As Amended Is Valid and Constitutional.

(a) Section 77B of the Bankruptcy Act Is a Law on the Subject of Bankruptcies and Deals With a Subject Upon Which Power Has Been Granted to Congress and Is Therefore, Not in Contravention of the Tenth Amendment to the Constitution of the United States.

In fairness to the trial court, it may be suggested that at the time of the filing of the petition herein, section 77B was then a comparatively recent enactment and the extent of the jurisdiction of the courts thereunder was unsettled and undetermined. Appellant respectfully contends that the constitutionality of the sections of the bankruptcy act relating to corporate reorganizations (sections 77A and B; 11 U. S. C. A., sections 206, 207), would seem to be definitely settled by the opinion in the recent case of *Continental Illinois National Bank & Trust Co. v. Chicago R. I. & P. R. Co.,* 294 U. S. 648; 79 L. Ed. 1110. In the foregoing case, the Supreme Court, after an extensive discussion of the history and scope of the bankruptcy clause of the Constitution and citing a railway case decided by it under an analogous Canadian law, held that section 77 of the Bankruptcy Act, (11 U. S. C. A. section 205) relating to the reorganization of interstate railroads, was clearly within the power conferred upon Congress by the bankruptcy clause. While the decision in the so-called *Rock Island* case, *supra,* is limited in effect to section 77, and nothing is said in the opinion with respect to the constitutionality of section 77B, there would seem to be but little doubt that the court would reach the same result in connection with the

latter statute, since, except for the difference in the kind of corporations included therein, the provisions of the two statutes are practically indentical.

This point was brought out and considered by the Circuit Court of Appeals in *Grand Boulevard Investment Co. v. Strauss* (1935; C. C. A. 8th) 78 Fed. (2d) 180, in which the court, relying upon the similarity between section 77 and section 77B, held that the decision of the Supreme Court in the *Rock Island* case was conclusive on the question of the constitutionality of section 77B. And *in re Manbeach Realty Corporation* (1935 D. C.) 10 Fed. Supp. 523 at 525, the court states that the opinion of the Supreme Court with respect to section 77 presages a decision that section 77B will also be held to be constitutional.

In so far as appellant has been able to ascertain in most of the cases decided in the lower federal courts, section 77B has been assumed to be constitutional, no objection being raised on that ground. In the few cases in which the question has been directly considered and passed upon, the courts have been unanimous in upholding the constitutionality of the statute.

Re Central Funding Corporation, (1935; C. C. A. 2d) 75 Fed. (2d) 256;

Campbell v. Alleghany Corp., (1935; C. C. A. 4th) 75 Fed. (2d) 947;

Re New Rochelle Coal & Lumber Co., (1935; C. C. A. 2d) 77 Fed. (2d) 881;

Grand Boulevard Investment Co. v. Strauss, (1935; C. C. A. 8th) 78 Fed. (2d) 180;

Re Pierce Arrow Sales Corp., (1935; D. C. N. Y.) 10 Fed. Supp. 776;

Re Hotel Gibson Co., (1935; D. C. Ohio) 11 Fed. Supp. 30.

In the objections and exceptions to the proposed plan of reorganization filed by the appellees, reference therein was made to the decision of the Supreme Court in holding the Frazier-Lemke Act unconstitutional. However, this decision of the Supreme Court (*Louisville Joint Stock Land Bank v. Redford,* 55 S. Ct. Rep. 854) has been held not to affect the constitutionality of section 77B, the two statutes being entirely different both in scope and purpose.

> *Re Consolidation Coal Co.,* (1935; D. C. Md.) 11 Fed. Supp. 594 at 596.

The power granted to Congress to pass uniform laws on the subject of bankruptcy is unrestricted and paramount, (*International Shoe Co. v. Pinckus,* 278 U. S. 261 at 263) and the power thus delegated is an express grant and so far as the granting clause is concerned, is without qualification or limitation. In *Campbell v. Alleghany Corporation,* (1935; C. C. A. 4th) 75 Fed. (2d) 947, it was said that the power granted to Congress to establish uniform laws on the subject of bankruptcy embraced all phases of the relationship between a debtor financially embarrassed and his creditors. And the fact that secured debts were effected by the provisions of section 77B was there held not to be an objection to its constitutionality, a secured debt being no more sacred than an unsecured debt. Indeed under the authority of *Continental Illinois etc. Co. v. Chicago, etc. Ry. Co., supra,* such holding may be deemed to be without serious question.

Appellant therefore respectfully asserts that section 77B of the Acts of Bankruptcy, as amended, is a proper subject of bankruptcy upon which the power to legislate has been expressly granted to Congress and the section does not violate the tenth amendment of the Constitution.

(b) Section 77B, in Its Application and Operation, and Particularly in the Instant Case, Would Not Deprive Persons of Their Property Without Due Process of Law, or Otherwise Violate the Fifth Amendment to the Constitution of the United States.

At the time of the hearing on the proposed plan of reorganization it was emphatically contended by appellees that if the proposed plan as submitted was approved the same would deprive the bondholders of certain substantive rights specifically set forth in the written objections made thereto; and that if section 77B sanctioned or established such procedure it was invalid and unconstitutional under the fifth amendment to the Constitution.

Under the authority of *Continental etc. Co. v. Chicago etc Co.,* 294 U. S. 648, it must be held that section 77B does not violate the fifth amendment to the Constitution as taking property without due process of law, or otherwise. For the same reason, it must be held that any proceedings had or taken pursuant to or in compliance with the provisions of said section, or orders made thereunder, are not a violation of the fifth amendment and do not constitute a taking of property without due process.

Indeed, such has been the holding of various United States Circuit and District Courts. See:

Campbell v. Alleghany Corporation, (1935; C. C. A. 4th); 75 Fed. (2d) 947;

Re Hotel Gibson Co., (1935; D. C.) 11 Fed. Supp. 30;

Re Pierce Arrow Sales Corp., (1935; D. C.) 10 Fed. Supp. 776.

For like reasons it must also be conceded that if an order approving a proposed plan of reorganization were made pursuant to and in compliance with the provisions of section 77B, such plan, and all orders made in compliance therewith and pursuant to its provisions, would not be a violation of the due process clause. The fact that creditors affected thereby may be secured lien holders does not alter the situation for, in so far as due process of law is concerned, a secured debt is no more sacred than an unsecured debt.

Campbell v. Alleghany Corporation, (1935; C. C. A. 4th) 75 Fed. (2d) 947, at 954;

In re Central Funding Corp., (1935; C. C. A. 2d) 75 Fed. (2d) 256.

In the proposed plan of reorganization it was contemplated that new bonds be issued equal in amount to the unpaid defaulted principal of the outstanding bonds. These new bonds, when so issued, were to be first liens upon all of the assets and property previously covered by the outstanding bonds. Thus it is apparent that there was no real change in the position or security of the bondholders. The proposed plan of reorganization and new issue of bonds provided a fair equivalent for any right

which the bondholders might have under the outstanding defaulted bonds. Where a plan of reorganization provides a fair equivalent for any right a creditor might lose, such deprivation is no more than that involved in any bankruptcy administration and does not therefore amount to the taking of property without due process.

> *Re Central Funding Corporation,* (1935; C. C. A. 2d), 75 Fed. (2d) 256 at 261.

The fact that under the proposed plan of reorganization only the defaulted principal of outstanding bonds in the sum of $524,000 was to be covered by a new issue of bonds and that the bondholders would be required to waive unpaid interest, does not amount to a denial of due process for it was held in *Campbell v. Alleghany Corp., supra,* 75 Fed. (2d) 947 that where a plan of reorganization was filed pursuant to and in compliance with the provisions of section 77B, which plan would require creditors to scale their debts in accordance therewith, the same did not amount to a denial of due process. While it is true that in the foregoing case the plan of reorganization there approved was acceptable to two-thirds of the creditors, nevertheless, a scaling down of debts was required of other non-assenting creditors. The legal principle there involved was whether or not a plan of reorganization filed pursuant to the provisions of section 77B and which required creditors to scale their debts in accordance with such a plan, constitutes a denial of due process to such non-assenting creditors. The court held it did not, for the following reasons:

> "The statute is of a remedial character, designed to facilitate the reorganization of corporate business made necessary by the economic depression through

> which the country has been passing. Its purpose should be forwarded by a fair and liberal construction of its provisions, not thwarted by any narrow or technical interpretation, and certainly not by reading into its language conditions and limitations which the lawmakers themselves did not see fit to express. And we entertain no doubt as to the constitutionality of the statute. * * * As a matter of fact, no property in any real sense is taken from the dissenting creditor when he is compelled under 77B to scale his claim and accept securities in lieu thereof. The securities held by him have already shrunk in value before the proceeding under the act is instituted; and all that is required of him is that he face reality and accept his pro rata interest in the debtor's property in a form which will not jeopardize the rights of other creditors similarly situated."

As the court pointed out in the foregoing case, non-assenting creditors were not really deprived of any property at all by the adoption of a plan of reorganization since their claims had already shrunk in value before the adoption of the plan and it merely required them to scale down their claims to their real value. Such is exactly the situation in the present case, so far as the defaulted interest payments are concerned. Here the bondholders are deprived of nothing; for in the final analysis the substantive security or property right which they had is their lien upon the land and building of the debtor and not to unpaid or defaulted interest. The mere fact that the bondholders would receive new bonds only in a sum equal to the defaulted principal amount of the outstanding bonds without the addition of interest thereto, does

not therefore deprive them of any substantive right. The addition of interest would be but an inflation or watering of the true value of the claims of such bondholders and would not tend to increase the value of their security, or the probability to them of the realization of the real value of their claims. So long as their claims are secured by the same physical properties, both real and personal, they are not deprived of any substantive property right.

It was also contended at the hearing on the proposed plan of reorganization that the proposed plan, while affecting the rights of bondholders, failed to provide that it should become effective only upon the acceptance in writing by the holders of two-thirds of the amount of said bonds, which constituted a denial of the due process clause.

It is apparent from the pleadings herein that appellant would have been unable to acquire the acceptance in writing by the holders of two-thirds in amount of said bonds to any plan of reorganization which it might have proposed because and by reason of the fact that the S. W. Straus & Co. bondholders protective committee owned under their deposit agreement, an amount in bonds equivalent to 92.24% of all outstanding bonds and at all times had failed, neglected or refused to consider the equities and rights of appellant in or to said property.

Doubtless, in anticipation of exactly such a contingency, Congress very wisely established and set forth in section 77B, a means whereby a plan of reorganization might

be presented and confirmed by the court without the consent in writing of a majority of the creditors of the debtor. This provision, we believe, is found in clause 5, subdivision (b) of said section 77B, being as follows:

> "(b) A plan of reorganization within the meaning of this section (5) shall provide in respect that each class of creditors of which less than two-thirds shall accept such plan (unless the claims of such creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full) provide adequate protection for the realization by them of the value of their interests, claims or liens, if the property affected by such interests, claims or liens is dealt with by the plan, either as provided by the plan (a) by the transfer or sale of such property, subject to such interests, claims, or liens, or by the retention of such property by the debtor, subject to such interests, claims or liens, or (b) by a sale free of such interests, claims or liens at a price not less than a fair up-set price and the transfer of such interests, claims or liens to the proceeds of such sale; or (c) by appraisal and payment either in cash of the value of such interests, claims or liens or, at the objecting creditor's election, of the securities allotted to such interests, claims or liens under the plan, if any, shall be so allotted; or (d) by such method as will, in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

If it be conceded, for the purpose of argument only, that the due process clause of the Constitution may limit the power of Congress or the manner of its exercise under the bankruptcy clause, nevertheless, it does not

vitiate the bankruptcy clause. The Constitution is not self destructive.

> "The powers it confers on one hand it does not immediately take away."
>
> *Billings v. U. S.*, 232 U. S. 262, at 282;
>
> *McCrary v. U. S.*, 195 U. S. 27.

In considering this phase of the constitutionality of section 77B it must be assumed that Congress, in adding amendments concerning relief of debtors, intended to amplify the procedure and grant authority for wider relief of a more general application.

> *Continental etc. Co. v. Chicago etc. Ry. Co.*, 294 U. S. 648; 79 L. Ed. 1110.

Furthermore, it is a rule of long standing that the judiciary should move with extra caution in declaring the acts of Congress unconstitutional and should only do so after a showing of their invalidity of the clearest character, in the clearest cases and in the absence of any possibility of a reasonable construction resulting in their constitutionality.

> *Fletcher v. Peck*, 6 Cranch. (10 U. S.) 87, at 128 3 L. Ed. 162.

This doctrine was recognized by Chief Justice John Marshall in the foregoing case where, at page 128, he states:

> "The question whether a law be void for its repugnancy to the constitution is, at all times, a question of much delicacy, which ought seldom, if ever, to be decided in the affirmative in a doubtful case. The Court, when impelled by duty to render such a judg-

ment, would be unworthy of its station, could it be unmindful of the solemn obligations which that station imposes. But it is not on a slight implication and vague conjecture that the legislature is to be pronounced to have transcended its powers and its acts to be considered as void. The opposition between the constitution and the law should be that the judge feels a clear and strong conviction of their incompatibility with each other."

In the subsequent case of *Nicol v. Ames,* 173 U. S. 509, at 514, it was stated:

"It is always an exceedingly grave and delicate duty to decide upon the constitutionality of the act of the Congress of the United States. The presumption, as has frequently been said, is in favor of the validity of the act; and it is only when the question is free from any reasonable doubt that the court should hold an act of the law-making power of a nation to be in violation of the fundamental instruments upon which all of the powers of government rest."

The words "due process of law" as used in the fifth amendment to the Constitution have no mysterious or hidden significance. They mean but the law of the land.

Murray v. Hoboken Land & Improvement Co., 18 How. 272, 15 L. Ed. 372.

So long as property is taken under the law of the land, such taking constitutes due process. It has been frequently held that law, in its regular administration through the courts of justice (*Leeper v. Texas,* 139 U. S. 462, 35 L. Ed. 225) or any legal proceeding enforced by

public authority, whether sanctioned by usage and custom of newly devised legislative acts (*Hurtado v. Calif.,* 110 U. S. 516, 28 L. Ed. 232) is due process of law.

The particular form or manner of the proceedings will be disregarded in determining what constitutes due process. Regard must be had to substance, not form.

Chicago, etc. Railway Co. v. Chicago, 166 U. S. 226, 41 L. Ed. 979;

Simon v. Craft, 182 U. S. 427, 45 L. Ed. 1165;

Western Life Indemnity Co. v. Rupp, 235 U. S. 226, 59 L. Ed. 220.

It must be conceeded under the authorities heretofore cited that Congress has the unqualified and unlimited power to establish uniform laws on the subject of bankruptcy throughout the United States, which grant of power has been held to be unrestricted and paramount. Furthermore, it cannot be denied that under the authorities hereinbefore referred to, section 77B is a law upon the subject of bankruptcies properly enacted pursuant to the power granted to Congress; therefore, it is obvious that section 77B is the "law of the land". Hence any proceeding had, thing done, plan of reorganization proposed, or orders made to enforce the same, if made or done pursuant to and in compliance with the provisions of section 77B, would constitute and be due process of law in so far as the parties effected thereby are concerned.

Therefore, should the court, in the exercise of its jurisdiction, approve a plan as fair, equitable and feasible and scale down a claim by cancelling interest such order is valid and binding upon all parties within the jurisdiction

of the court and constitutes due process; even though such parties refused to consent thereto.

The only requirement of due process is an opportunity to be heard; no fixed procedure is demanded or required, for the due process or due proceedings contemplated by the fifth amendment may be adapted to the nature of the case.

Ballard v. Hunter, 204 U. S. 241, 51 L. Ed. 46.

So in the instant case, if the court, in the exercise of its jurisdiction, made an order approving the proposed plan of reorganization which plan has not been consented to by two-thirds of the creditors effected thereby, and subsequent orders were made to enforce the same or carry it into effect such order so made would not constitute a deprivation of substantive property rights without due process of law if such creditors had due and regular notice of the proceedings, were actually in court and could and did, by evidence and argument, challenge the result. Such is the procedure constituting due process contemplated and set forth in section 77B and which gives to the creditors their day in court at every step of the proceedings where they may, by evidence and argument, challenge the result, and such procedure constitutes due process, although it may seem to be irregular.

West Ohio Gas Co. v. Public Utilities Commission, 55 S. Ct. Rep. 316, at 320.

No claim of irregularity or error in the procedure or proceedings has ever been made or contended. Nor has it ever been contended that the plan filed by appellant and the proceedings in connection therewith did not comply with the provisions of section 77B.

A party has not been deprived of his property without due process of law nor as regards the issues affecting it, if he has had, by law, a fair hearing in a court of justice, according to the modes of procedure in such a case.

Marchant v. Penn. Railway Co., 153 U. S. 380, 38 L. Ed. 751.

Due process of law is not denied by applying the specific provisions of section 77B to secured lien holders, where such secured creditors are given an opportunity to appear and contest the fairness of the plan of reorganization.

Re Hotel Gibson Co. (1935, Dist. Ct.), 11 Fed. Supp. 30.

Nor is it a denial of due process to contend that the exercise by the court of powers lawfully conferred upon it by the provisions of section 77B tends to vary or defeat the provisions of a private contract which, in this case, are provisions of the trust deed particularly with respect to payment of principal or interest, the application of funds held in a sequestered account by the trustee in possession, and the right to have a trustee named in the trust indenture and chattel mortgage, control the property and collect the income.

Continental etc. Co. v. Chicago etc. Ry. Co., 294 U. S. 648, 79 L. Ed. 1110;

Louisville etc. Co. v. Motely, 219 U. S. 407, at 485.

For it has been frequently held that private contracts may not impose a restriction upon the exercise of a constitutional power.

Louisville, etc. Railway Co. v. Motley, 219 U. S. 407, at 485;

Monongahela Bridge Co. v. United States, 216 U. S. 177, at 193;

Addison Pipe & Steel Co. v. U. S., 175 U. S. 211, at 229.

"The grant to Congress (of the power to establish bankruptcy laws) involves the power to impair the obligations of contracts, and this the states were forbidden to do." (Parenthesis added.)

Hanover National Bank v. Moises, 186 U. S. 181, at 188.

It was also held in *Continental etc. Co. v. Chicago etc. Railway Co.,* 294 U. S. 648, 79 L. Ed. 1110, that: (1) the deprivation of secured creditors of their right to retain the lien upon the property of the petitioning debtor until the indebtedness thereby secured is paid; (2) to dprive secured creditors of the right to realize upon the security by a sale conducted by the trustee appointed in the trust indenture or by a judicial public sale; (3) to deprive such creditors of the right to determine when such sale shall be held; (4) restraining and depriving secured creditors of the right to bid at such sale and thereby having the pledged property devoted exclusively to the satisfaction of their debt; where such deprivation of such purported substantive rights is made pursuant to, and in compliance with the Acts of Bankruptcy, and particularly section 77, did not constitute a taking of property without

due process of law. Under the authority of the foregoing case it must be specifically held that the same rules are also applicable to section 77B.

Therefore, appellant respectfully asserts that under the authorities above set forth, specific objections 1 to 7 inclusive of appellees' general objection No. I [Tr. pp. 40 to 42], and specific objection No. 2, under appellees' general objection No. II [Tr. p. 42] and general objection No. III [Tr. p. 44] should be overruled and denied. Therefore, if appellant is such a corporation as is contemplated by section 77B, and the proposed plan is fair, equitable and feasible, it should be approved and it was error for the trial court to refuse so to do.

II.

Francisco Building Corporation, Ltd., Appellant Herein, Is a "Debtor" and the Bondholders Are "Creditors" Within the Meaning, Definitions and Provisions of Section 77B.

Appellees' general objection No. V contends that the owners and holders of the bonds are not creditors of appellant since the bonds were neither issued nor assumed by appellant, the petitioning debtor herein.

In defining a creditor, subdivision (b) clause 10 of section 77B states as follows:

> "The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor *or its prop-*

> *erty,* including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts, securities, other than stock, liens or other interests of whatever character." (Italics added.)

With respect to who may take advantage of the provisions of section 77B, the said section in subdivision (a) thereof states as follows:

> "Any corporation which could become a bankrupt under Section 4 of this Act, and any railroad or other transportation corporation, except a railroad corporation authorized to file a petition or answer under the provisions of Section 77 of this Act, and except as hereinafter provided, may file an original petition . . ."

Under the provisions of section 4 of the Acts of Bankruptcy above referred to it is therein provided in substance that any corporation other than a railroad, insurance or banking corporation or a building and loan association may avail themselves of the provisions of the Acts of Bankruptcy.

The contention of appellees as above set forth completely ignores the plain and evident meaning of the definition of a "creditor" as set forth in section 77B. The definition provides that a "creditor" shall include, for the purposes of section 77B, all holders of claims of

whatever character, not only against the corporation itself but also in cases where such claims constitute liens upon or against the *property* of a corporation. Therefore, it is obvious that under the definition of a creditor, two distinct situations are anticipated; first, where the debtor is directly or primarily liable to the creditor; *or* second, where the property of a corporation is subject to the claim or liens of some other person who thereupon is considered a "creditor". The claims or liens contemplated by section 77B include liens or other interests of whatever character upon the property of the petitioning corporation, as well as the primary or original obligations of a corporation.

The case of *In re Draco Realty Corporation* (1934 D. C. N. Y), reported at section 3045 of Commerce Clearing House Bankruptcy Law Service, and cited by appellees in support of their general objection No. V, fails to recognize the distinctions and definitions set forth in section 77B and fails to give any consideration whatsoever to the same.

Appellant respectfully asserts that it was undoubtedly the purpose of section 77B and the intention of Congress in enacting the same to not only include within its provisions corporations originally or primarily liable to third persons but also corporations whose assets or property are subject to liens or claims of third persons. This intention is evident upon an analysis of clause 10, subdivision (b) of section 77B of the Act above quoted.

It is obvious that in defining the relationship of debtor and creditor it was not intended, in so far as section 77B is concerned, to confine the same to the former narrow sense of primary or direct liability, but that it was intended to enlarge the scope and purpose of the said section by including in its provisions corporations whose *property* was subject to a direct lien or claim. No other meaning can be given to the phraseology used by Congress in clause 10 of subdivision (b). The purposes of the statute "should be forwarded by a fair and liberal construction not thwarted by any narrow or technical interpretations, and certainly not by reading into its language conditions and limitations which the lawmakers themselves did not see fit to express."

> *Campbell v. Alleghany Corp.* (1935; C. C. A. 4th), 75 Fed. (2d) 947 at 950.

It cannot be denied that the bondholders were lienors having claims against the property of appellant and are therefore considered as creditors under the definition of clause 10 of subdivision (b) of section 77B. Being creditors, and appellant being such a corporation as could become a bankrupt under section 4 of the Act, it is evident that the relationship of "debtor" and "creditor" as contemplated and defined by section 77B exists. Obviously, appellees' general objection No. V was without merit and the same should be overruled.

III.

The Proposed Plan of Reorganization, As Amended, Is Fair, Equitable and Feasible.

Having heretofore considered and discussed appellees' general objections numbers I, II, III and V under points I and II heretofore made, the last and one of the most important matters to be determined by this Honorable Court is the question of whether or not the proposed plan of reorganization, as amended, is fair, equitable and feasible.

As previously stated it is provided in section 77B that if, in the opinion of the court, a proposed plan of reorganization is fair, equitable and feasible, and with respect to classes of creditors of which less than two-thirds in amount accept the plan, makes adequate provision for the realization by them of the value of their interest, then notwithstanding the non-acceptance of the plan by such class of creditors, the court, nevertheless, has jurisdiction to approve the same.

It should not be denied that under the proposed plan the bondholders have adequate protection for the realization by them of their interests. This, by reason of the fact that the same security is offered to them as they originally had, together with the further fact that the entirely eliminated, that general economics can be effected expense of trustee's fees will be greatly reduced, if not because of centralized management; furthermore, th plan proposes the same provisions with respect to the right of future foreclosure as is set forth in the plan of reor-

ganization proposed and adopted by appellees, namely, that if the minimum interest requirements of any particular year are not met, the bondholders have the right to foreclose under the proposed new trust deed and chattel mortgage.

The foregoing provisions in the proposed plan, as well as many others, certainly provide the secured creditors of the debtor corporation with ample and adequate protection by them for the realization of the real value of their interests.

After Messrs. H. H. Cotton, Chas. C. Irwin, John Treanor and J. B. Van Nuys had been constituted the First Mortgage Bondholders' Protective Committee and under date of June 26, 1934, Wilfred N. Howard, secretary for the committee, forwarded to the depositors of bonds, a Medical Center Building Reorganization Plan. This plan was an exhibit introduced in the case by appellees and is specifically set forth at pages 67 to 83 of the transcript.

Undoubtedly, it must have been the opinion of appellees in presenting their plan to the depositors that the same was fair and equitable and offered holders of bonds ample security and provision for a realization by them of the value of their interests.

Under this plan new bonds were to be issued in the principal amount equal to the principal amount of the present bonds deposited with the committee which, in no event, would exceed $524,500.00. This is exactly the same provision as in the debtor's plan. The provisions of each plan as to how such bonds are to be secured are

identical; so are the provisions with respect to payment of interest. The provisions of each plan are similar with respect to priority of payments from cash receipts. In fact, the only fundamental difference between the plan as proposed by appellees and the plan as proposed by debtor appellant is that appellant was to remain the legal owner of the property in question under the later plan, whereas, in the plan of appellees, a new corporation was to be formed, which would become the owner and holder of the premises and stock of this corporation was to be issued to a voting trust, undoubtedly to be composed of members of the present protective committee. Thus control is perpetuated in them.

It will be observed that in so far as fees and expenses of administration are concerned, the plan proposed by appellant herein would eliminate and reduce various trustees' fees. Whereas, in the plan of appellees, at least two trusts are created with the resultant additional expense for trustees and attorneys' fees which invariably arise in cases such as this.

Furthermore, specific objections 3, 4, 5 and 6 of general objection II [Tr. pp. 42 to 44] have been completely met by the amendments made to appellants' proposed plan, which amendments are set forth at pages 85 and 86 of the transcript. These amendments provided that new bonds should be issued in the principal amount of the outstanding old bonds; that such new bonds should be exchanged, dollar for dollar, for old bonds; that all funds received by appellant in excess of actual expenditures to be paid

as designated and set forth in article III, paragraphs 4 and 6 of appellant's plan were to be used for retirement purposes. No such provision is found in appellees' plan. No part or portion of such funds were to be used by appellant for any of its own purposes.

The primary object and purpose of appellant in filing its petition and submitting a plan of reorganization was and is to afford it the opportunity to rehabilitate and save its investment, business and property, and, as past disastrous economic conditions improve, which they have, to permit it, out of the income of its business, to pay off its secured creditors. There has never been any intention or desire on the part of appellant to, in any wise or at all, jeopardize the security of the bondholders or to propose a plan which was not fair and equitable to all of the parties.

Appellant earnestly asserts that the interests of justice and equity require that consideration be given to its equity and expenditures in said land and building, which approximates the sum of $300,000.00. It was for the purpose of attempting to salvage its said equity that the plan was proposed. The land and building represent an investment in excess of $1,000,000.00, and the fair value thereof or replacement cost is in excess of the indebtedness against it.

Can it be said that the plan is unfair or inequitable when it offers to the creditors the same security which they had and furthermore, is in no fundamental respect

different than their own plan other than it affords appellant an oportunity to rehabilitate itself? Such opportunity is the very purpose of section 77B, and the provisions thereof should be extended to appellant.

Furthermore, the plan is feasible. This is apparent from an analysis thereof. Appellees, in their general objection No. IV [Tr. p. 45] contended that the plan was not feasible because a permit of the California Corporation Commissioner would be required and under its rules and regulations, such a permit could not be obtained to issue the new bonds.

The objection has no merit for the following reasons:

1. Appellant's proposed plan provided in article VIII as follows [Tr. p. 34]:

> "This plan of reorganization is subject to the approval and acceptance of the Court and of *any public authorities having jurisdiction over the same* . . ."

2. Appellees, in their said objection, anticipated and assume that a petition for a permit to issue stock pursuant to a plan of reorganization filed under the laws of the United States and approved by a United States District Court as having been fair, equitable and feasible, will be denied by the State Corporation Commissioner. Such a contention is absurd and has no merit. This point was not stressed at the hearing and undoubtedly was not determinative of the issues presented by the various petitions and objections.

Conclusion.

In conclusion, appellant respectfully asserts that section 77B of the Acts of Bankruptcy as amended is constitutional in all respects; that under the provisions of the said section a court has jurisdiction to approve a plan of reorganization which is fair, equitable and feasible and which makes adequate provision for the realization by creditors of the value of their interests without the consent of two-thirds or more in amount of such creditors to said plan; that such order of the court pursuant to the jurisdiction lawfully conferred upon it by section 77B is not a denial of the due process clause of the Constitution; that a court has power under the jurisdiction lawfully conferred upon it by section 77B to compel creditors to waive interest claims upon their debts and by so doing it does not deprive such creditors of property without due process of law; that appellant herein is a debtor and that the bondholders are creditors within the meaning, definition and provision of section 77B; and finally that the plan of reorganization proposed by appellant as amended is fair, equitable and feasible and makes adequate provision for realization by the bondholders of the value of their interests.

Appellant further respectfully contends that each and all of the objections and exceptions made to appellant's proposed plan of reorganization by appellees herein should have been overruled and denied by the trial court, and that the trial court should have approved the plan of reorganization proposed by appellant and should have made all necessary orders to carry the same into effect and to grant to appellant all of the relief provided for in section 77B of the Acts of Bankruptcy, as amended.

Appellant earnestly asserts that this Honorable Court should find that the plan of reorganization proposed by appellant as amended is fair, equitable and feasible; that the same makes adequate provision for a realization by them of the value of their interests; that the said plan of reorganization complied with and was pursuant to each and all of the provisions of section 77B of the Acts of Bankruptcy, as amended, and that the same should be approved and accepted.

Furthermore, that this Honorable Court should reverse the order made by the Honorable William P. James on July 29th, 1935, rejecting the debtor's proposed plan of reorganization and vacating and setting aside the restraining order; that this further court should make its order or decree approving appellant's proposed plan of reorganization as amended; that the trial court be ordered and directed to make all necessary orders to carry the said plan into full force and effect; that each and all of the provisions of section 77B of the Acts of Bankruptcy be declared applicable to appellant and that appellant be allowed to take advantage thereof and that speedy justice should be done to the parties in that behalf.

Respectfully submitted,

ELBERT E. HENSLEY,
JOHN H. KLENKE,
Attorneys and Solicitors for Appellant.